Chapter Three
Current Liabilities

Introduction

Dear learner! In the previous chapter, you have learnt the basic accounting principles and practices that are useful in accounting for the acquisition, use, and disposal of plant assets, as well as the accounting for intangible assets and natural resources. In this chapter, you will be acquainted with the basics of accounting for current liabilities and payroll and payroll taxes. A few of common types of current liabilities such as notes payable, accounts payable, and payroll related liabilities will be discussed in this Chapter.

Learning Objectives

After studying this chapter, you should be able to:

- Explain a current liability
- Identify the major types of current liabilities.
- Record current liabilities
- Perform payroll related accounting activities
- Compute and record the payroll for a pay period.
- Determine employer liabilities for payroll, including liabilities arising from employee earnings and deductions from earnings.
- Describe and record employer payroll taxes.

- Journalize entries for employee fringe benefits, including vacation pay and pensions
- Explain the financial statement presentation and analysis of current liabilities.

3.1 The Nature of Liabilities

FASB defines liabilities as follows:

Liabilities are the probable future sacrifices of economic benefits arising from present obligations of a company to transfer assets or provide services in the future as a result of past transactions or events.

The FASB also explained two of the terms. The word ***probable*** refers to what can be expected or believed based on available evidence or logic. The word ***obligation*** refers to duties imposed legally or socially which one is bound to do by contract, promise, or moral responsibility. In other words, liabilities include both legal and non-legal (but not illegal) obligations. Legal liabilities are incurred in transactions that are contractual-based on written or oral agreements to pay cash or to provide goods or services to other entities in the future. Legal liabilities include such items as accounts payable, notes payable, and sales tax payable. The non-legal group (also called accounting liabilities) includes those obligations where there is no legal requirement for assets to be transferred, but a transfer of assets typically occurs as a part of the normal operations of a business. Non-legal liabilities include equitable and constructive obligations, such as the liability to employees for vacation pay or year-end bonuses. These are obligations that a company accepts by paying them every year even though it is not contractually required and has not announced a policy to do so.

There are three characteristics of a liability for a company:

1. A liability involves a responsibility that will be settled by the probable future transfer or use of assets at a specified or determinable date, on occurrence of a specific event, or on demand.
2. The responsibility obligates the company so that it has little or no discretion to avoid the future sacrifice.
3. The transaction or other event obligating the company has already happened.

Liabilities generally are classified as either current or long-term. We discuss the issues relate to current liabilities in this chapter.

Current liabilitiesare obligations of a company that it expects to liquidate by using existing current assets or creating other current liabilities within one year or the normal operating cycle, whichever is longer. The usual criterion is one year.

For certain companies, however, where the operating cycle - from cash to inventory to receivables and back to cash - is longer than a year, the length of the operating cycle determines the classification of the liability. Many current liabilities, such as accounts payable, wages payable, warranty obligations, and notes payable, are incurred (and paid) during the operating cycle. Most current liabilities arise from two basic transactions:

- Receiving goods or services prior to making payment

- Receiving payment prior to delivering goods or services.

In addition, a current liability, Salaries Payable, arises as a result of accrued salaries for sales, as well as general and administrative, personnel.

3.2 Classification of Current Liabilities

A company reports its current liabilities in the first section of its liabilities on its balance sheet. Many current liabilities are easily identifiable and have a "contractual" amount. Some current liabilities, though identifiable, have amounts that depend on operations. Others require that amounts be estimated. The primary types of current liabilities are classified in three groups, as shown in the following exhibit, although some types might fit in more than one category.

1.2.1. Accounts Payable

Accounts payable transactions have been described and illustrated in earlier chapters (in Principles of Accounting I). These transactions involved a variety of purchases on account, including the purchase of merchandise and supplies. For most companies, accounts payable is the largest current liability.

1.2.2. Short-Term Notes Payable

Companies record obligations in the form of written notes as notes payable. Notes payable are often used instead of accounts payable because they give the lender formal proof of the obligation in case legal remedies are needed to collect the debt.

Companies frequently issue notes payable to meet short-term financing needs. Notes payable usually require the borrower to pay interest. Notes are issued for varying periods of time. Those due for payment within oneyear of the balance sheet date are usually classified as current liabilities.

Notes may be issued to purchase merchandise or other assets. Notes may also be issued to creditors to satisfy an account payable created earlier.To illustrate, assume that Sunshine Company issued a 90-day, 12% notefor $1,000, dated August 1, 2013, to Nature Company for a $1,000 overdue account. The entry to record the issuance of the note is as follows:

Aug.	1	Accounts payable – Nature Co. Notes payable	1,000	 1,000
		(issued a 90-day, 12% note on account)		

When the note matures, the entry to record the payment of $1,000 plus $30 interest ($1,000x12% x 90/360) is as follows:

Oct.	30	Notes payable Interest expense Cash	1,000 30	 1,030
		(paid principal and interest due on note)		

The interest expense is reported in the "*Other Expense*" section of the income statement for the year ended December 31, 2014. The interest expense account is closed atDecember 31.

Each note transaction affects a debtor (borrower) and creditor (lender). Thefollowing illustration shows how the same transactions are recorded by the debtor andcreditor. In this illustration, the debtor (borrower) is **Bowden Co**., and the creditor(lender) is **Coker Co**.

	Bowden Co. (Borrower)	Coker Co. (creditor)
May 1:Bowden Co. purchased merchandise on account from Coker Co. $ 10,000, 2/10,n/30. The merchandise cost Coker Co. $ 7,500.	Merchandise inventory 10,000 Accounts payable 10,000	Accounts receivable 10,000 Sales 10,000 Cost of merchandise sold 7,500 Merchandise inventory 7,500

May 31: Bowden Co. issued a 60-day,12% note for $10,000 to Coker Co. on account	Accounts payable 10,000 Notes payable 10,000	Notes receivable 10,000 Accounts receivable 10,000
July 30: Bowden Co. paid Coker Co. the amount due on the note of May 31. Interest: $10,000 x 60/360	Notes payable 10,000 Interest expense 200 Cash 10,200	Cash 10,200 Interest revenue 200 Notes receivable 10,000

A company may borrow from a bank by issuing a note. To illustrate, assume thaton September 19, 2013Nature Company issues a $4,000, 90-day, 15% note to Awash InternationalBank. The entry to record the issuance of the note is as follows:

Sept.	19	Cash Notes payable	4,000	 4,000
		(issued a 90-day, 15% note to AIB)		

On the due date of the note (December 18), Nature Company owes $4,000 plus interest of $150 ($4,000x15% x90/360). The entry to record the payment of the note isas follows:

Dec.	18	Notes payable Interest expense Cash	4,000 150	 4,150
		(paid principal and interest due on the note)		

In some cases, a discounted notemay be issued rather than an interest-bearing note. A discounted note has the following characteristics:

- ✓ The creditor (lender) requires an interest rate, called the *discount rate*.
- ✓ Interest, called the *discount*, is computed on the face amount of the note.
- ✓ The debtor (borrower) receives the face amount of the note less the discount, called the *proceeds*.
- ✓ The debtor pays the *face amount* of the note on the due date.

To illustrate, assume that on August 10, 2013, Sunshine Company issues a $20,000, 90-day discounted note to Awash InternationalBank. The discount rate is 15%, and the amountof the discount is $750 ($20,000x15%x90/360). Thus, the proceeds received by Sunshine Company are $19,250. The entry by Sunshine Company is as follows:

Aug.	10	Cash Interest expense Notes payable	19,250 750	 20,000
		(issued a 90-day discounted note to AIB at 15% discount rate)		

The entry when Sunshine Company pays the discounted note on November 8 is as follows:

Nov.	8	Notes payable Cash	20,000	 20,000
		(paid note due)		

1.2.3. Current Portion of Long-Term Debt

Long-term liabilities are often paid back in periodic payments, called **installments**. Companies often have a portion of long-term debt that comes due in the current year. That amount is considered a current liability. The installments due after the coming year are classified as a long-term liability.

To illustrate, ABC Corporation reported the following debt payments schedule in its Dec 31, 2007, annual report to shareholders:

Fiscal year ending	
2008	$ 775,000
2009	789,000
2010	337,000
2011	56,000
2012	0
Thereafter	550,000,000
Total principal payments	$551,957,000

The debt of $775,000 due in 2008 would be reported as a current liability on theDec 31, 2007, balance sheet. The remaining debt would be reported as a long-term liability on the balance sheet.

Other current liabilities that have been discussed in earlier chapters include accrued expenses, unearned revenue, and interest payable. The accounting for wages andsalaries, termed *payroll accounting*, is discussed next.

3.3 ETHIOPIAN PAYROLL SYSTEM

After completing this section, you will be able to;

- Define basic terms and documents involved in payroll accounting
- Explain the need for payroll accounting
- Calculate total earnings, deductions and net pay of employees
- Record payroll related liabilities

In accounting, payroll refers to the amount paid employees for services they provided during the period.

Payroll accounting is important for the following reasons:

- ✓ Employees are sensitive to payroll errors and irregularities.
- ✓ Good employee morale requires payroll to be paid timely and accurately.
- ✓ Payroll is subject to federal and state regulations. Both federal and state governments require that detailed payroll records be kept.
- ✓ Payroll often represents the largest expense that a company incurs.
- ✓ Adequate payroll system safeguards the financial resources of the organization from misuse and theft.

Accounting systems for payroll and payroll taxes are concerned with the records and reports associated with the ***employer-employee relationship***. It is important that the accounting system provide safeguard to ensure that payments are in accord with management's general plans and its specific authorizations.

All employees of an organization expect and are entitled to receive their remuneration at regular intervals following the close of each payroll period. Regardless of the number of employees and the difficulties in computing the amounts to be paid, the payroll system must be designed to process the necessary data quickly and assure payment of the correct amount to each employee.

The system must also provide adequate safeguards against unauthorized payments to employees and other misappropriations of funds. Various federal, state, and local laws require employers to keep accurate payroll records and to prepare reports and submit to the appropriate governmental units. The law also requires employers to remit the amounts withheld from its employees and for taxes imposed on it. These records must be kept for specified periods of time and be available for inspection by those responsible for enforcement of the laws. Besides, payroll data may be useful in negotiations with labor unions, in settling employee grievances, and in determining rights to vacations, sick leaves, and retirement pensions.
Here, in this section, we are going to discuss deeply and work-through the major concepts that are common to most payroll systems such as the employee's earnings record, payroll sheet (or register), and journal entries related to payroll. Each of these concepts is illustrated and discussed by taking into account the current tax law of the country. As much as possible it attempts to give you adequate knowledge about payroll systems in Ethiopia, however, if you come across any confusion or difficulties you can consult the authorities in the Ministry of Finance or Revenue Administration in your locality, or refer the various proclamations especially; Proclamation No. 979/2016 and Proclamation No. 983/2016.

1.3.1. Definition of Payroll Related Terms

Payroll accounting involves so many generally accepted and standardized terms. This helps to attain uniformity in the system both within the organization and with other related parties. The following are the most common terms used in payroll accounting:

1. **Salary and Wages**: salary and wages are usually used interchangeably. However, the term wages is more correctly used to refer to payments to unskilled-manual labor. It is usually paid based on the number of hours worked or the number of units produced. Therefore, wages are usually paid when a particular piece of work is completed weekly.

On the other hand, salaries refers to payments to employees who render managerial, administrative or similar services, and they are usually paid to skilled labor on a monthly or yearly basis.

Both wages and salaries are related to an 'employee,' that is, individual who works primarily to one organization and whose activities are under the direct supervision of the employer.

2. **Pay Period**:a pay period refers to the length of time covered by each payroll payment.
3. **Pay Day:** - is the day on which wages or salaries are paid to employees. This is usually on the last day of the pay period.
4. **A payroll Register (sheet**): is the list of employees of a business along with each employee's gross earning; deductions and net pay (take home pay) for a particular pay period. Then input for payroll register is the employees work hour duration summarized from any of the following sources:

   Attendance sheets: is where employees sign at the time of arrival in the working area. It is usually placed in offices and administrative areas.

   Punched (clock) cards; is an electronically recorded card, where each employee will have his/her own card for registering both at the time entering and leaving the working place. This mechanism is commonly placed at the gated of manufacturing plants.

   Time cards: is more or less similar to punched card except that the time is manually written in hand written format by the employee.
5. **Gross Earnings:** it is the total amount of income earned by employees from different sources.

   Gross Earning = Basic Salary +allowances + Overtime Earring

6. **Payroll Deductions**: are deductions from the gross earnings of an employee such as employment income taxes (withholding taxes), labor union dues, fines, credit association pays etc.

7. **Employment Income Tax**: are taxes collected from the earnings of employees by the employer organization as per the regulations of the government. These have to be submitted (paid) to the government because employer organization is only acting as an agent of the government in collecting these taxes for

employees.

8. **Pension contribution:**employersdeducts some amount of money from employees to provide some benefits to the employees after retirement and during old age, with a view to create a feeling of security about the old age to create a feeling of security about the old age. Pensions and provident funds benefits are called retirement benefits.Permanent employees of an organization governed by the existing regulations of the Ethiopian civil servants are expected to pay or contributed 7% of their monthly basic salary to the government pension trust fund. This amount should be withheld by the employer from the basic salary of each employee on every payroll and latter be paid to the respective government body.

   On the other hand, the employer is also expected to contribute 11% of the basic salary of every civil permanent employee towards the same fund. This amount is said to be payroll tax expense to the employer.

   Consequently, the total contribution to the pension trust fund of the Ethiopian government is equal to 18% of the total basic salary of all civil permanent employees of an organization.

9. **Net Pay: Net pay** is the earning of an employee's after all deductions have been made. This is take home pay amount collected by an employee on the pay day.

10. **Pay Check**: a business can pay payroll by witting a check for the amount of the net pay. A check is prepared in the name of each employee and handed to employee.Alternatively a check for the total net pay of all employees can be prepared so it will be paid in cash at the organization for each employee.

As per article 12 of the income tax proclamation, **employment income**s include the following:

- Salary, wages, allowance, bonus, commission, gratuity, or other remuneration received by an employee in respect of a past, current, or future employment;
- The value of fringe benefits received by an employee in respect of a past, current, or future employment;

- An amount received by an employee on termination of employment, whether paid voluntarily, under an agreement, or as a result of legal proceedings, including any compensation for redundancy or loss of employment, or a golden handshake payment.

1.3.2. Possible Components of a Payroll Register

1. **Employee Number**: number assigned to employees for identification purpose when a relatively large number of employees are involved in a payroll register.
2. **Name of Employees**
3. **Earnings:** Money earned by an employee from various sources. This may include.
   (a) **Basic Salary**- a flat monthly salary of an employee for carrying out the normal work of employment and subject to change when the employee is promoted.
   (b) **Allowances-** money paid monthly to an employee for special reasons, like:
   - ✓ **Position allowance**- a monthly paid to an employee of earning a particular office responsibility.
   - ✓ **Housing allowance**- a monthly allowance given to cover housing costs of the individual employee when the employment contract requires the employer to provide housing but the employer fails to do so.
   - ✓ **Hardship allowance**- a sum of money given to an employee to compensate for an inconvenient circumstance caused by the employer.For instance, unexpected transfer to aw different and distant work area or location.
   - ✓ **Desert allowance**- a monthly allowance given to an employee because of assignment to a relatively hot region.
   - ✓ **Transportation (fuel) allowance**- a monthly allowance to an employee to cover cost of transportation up to her workplace if the employer has committed itself to provide transportation service.

Overtime Earning: is the work done in excess of the normal daily hours of work. Normal hours of work shall not exceed 8 hours a day or 40 hours a week.

Overtime earnings are therefore the amount paid to an employee for overtime work performed.Normal hours of work; means that the time during which a worker actually performs work or avails himself/herself for work in accordance with law, collective agreement or work rules.

The overtime earnings are calculated with the following formula

Over time earnings (OTE) = OT hrs worked x ordinary hourly rate x OT rate.

According to article 68 of proclamation no.307/2003 and the amended proclamation no.494/2006, the following are set aside about overtime pay.

	Time of work done	Over time rate
1	6 am morning to 10 pm evening	1.25 times ordinary hourly rate
2	10 pm evening to 6 am morning	1.5 times ordinary hourly rate
3	Weekly rest days(Sunday and / or Saturday)	2 times ordinary hourly rate
4	public holiday	2.5 times ordinary hourly rate

$$\text{Ordinary hourly rate} = \frac{\text{Basic Salary}}{\text{Normal Hours of Work}}$$

4. **Gross Earning** = Basic Salary +allowances + Overtime Earring

5. **Deductions**: are subtractions made from the earnings of employees required by the government or permitted by the employee himself. These include:

(a) Employment Income Tax:

An employer paying employment income to an employee who is subject to employment income tax shall withhold tax from the gross amount of each payment of employment income at the rate applicable. In Ethiopia income tax is charged on the gross earnings of the employee at the rates indicated under Schedule A of the Proclamation No. 979/2016 - Income tax proclamation. An employee shall not be allowed a deduction for any expenditure incurred in driving employment income. Employment income shall not include exempt income.

The tax proclamation also provides some exemptions. Exemption, in this context, refers to income, which is not subject to tax. As per the proclamation, there are lists of income exempted from employment income tax:

Proclamation No. 979/2016 states that the following are not taxable

- ✓ An amount paid by an employer to cover the actual cost of medical treatment of an employee.
- ✓ Transportation allowance granted under a contact of employment
- ✓ Hardship allowance
- ✓ Reimbursed traveling expense and per diem (incurred on duty)
- ✓ Food and beverages provided for free to an employee by an employer conducting a mining, manufacturing or agricultural business.
- ✓ Contributions by an employer to a pension, provident fund or other retirement fund for the benefit of an employee provided for the monthly total of contributions does not exceed 15% of the monthly income
- ✓ An amount as compensation for personal injury or the death of another person
- ✓ Salaries paid to domestic servants

1.3.3. Employment income taxcomputation

Employment income tax is calculated using the following rates;

Employment Income (per month) in birr	Income Tax rate
0 – 600	0
601 - 1,650	10%
1,651 - 3,200	15%
3,201 -5,250	20%
5,251- 7,800	25%

7,801 – 10,900	30%
Greater than 10,900	35%

The most widely used employment income tax computation methods are progression and deduction.

A. Progression method

The amount of tax is calculated for each layer of tax brackets by multiplying the given rate under schedule for each additional layer. Assume that AtoGetenetAbebe earned an amount of birr 5,800 subject to income tax ;his employment income tax is calculated as follows.

Earning x tax rate (%) = income tax

600 x0 00.00

1050 x 10 105

1550 x 15 232.5

2050x20 410

550x 25137.5

5,800885

B. Deduction method

In preparation of payroll and computing the employment income tax,the following short cut formula can be used.

Income tax = (gross taxable income x tax rate)-deduction

Employment income tax(per month)		Tax rate (%)	Deduction(in birr)
Over birr	To birr		
0	600	0% (Exempt threshold)	0
601	1,650	10%	60
1,651	3,200	15%	142.5
3,201	5,250	20%	302.5
5,251	7,800	25%	565
7,801	10,900	30%	955

>10,900		35%	1,500

Example; we can calculate the income tax of AtoGetenetAbebe given in the previous example who earn the amount of birr 5,800 using deduction method as follows.

Income tax = (gross taxable income x tax rate)-deduction

Income tax = 5,800x 25% - 565

= **<u>Birr 885</u>**

The deduction the above table from the income tax payable computed as follows:

→ 60 = 600*10%-0 %(600-0)

→ 142.5= 1650*15%-10 %(1650-600) -0 %(600-0)

→ 302.5= 20% 3200*20%-15 %(3200-1650) -10 %(1650-600) -0 %(600-0)

→ 565=5250*25%-20 %(5250-3200) -15 %(3200-1650) -10 %(1650-600) -0 %(600 -0)

→ 955=7800*30%-25 %(7800-5250) -20 %(5250-3200) -15 %(3200-1650) -10 %(1650-600) -0 %(600-0)

(b) Pension Contribution:

The employer deducts pension contribution from Permanent employees of an organization 7% of their monthly basic salary to the government pension trust fund. This amount should be withheld by the employer from the basic salary of each employee on every payroll and latter be paid to the respective government body.

(c) Other Deductions:

In addition to the above two kinds of deductions from employees earnings, employees may individually authorize deductions such as deductions to pay health or life insurance premiums, to pay loans from the employer or credit association to pay for donation or charitable organizations; contributions to social affairs like "Idir" "Equb"; etc.

Each of the major other deductions may be put in special column in the payroll register.The sum of all the above-mentioned deductions (income tax, pension contribution, and other deductions) gives the total deduction from the gross earnings of an employee.

6. **Net Pay:**

This amount is held in one column of the payroll register representing the excess of gross earnings over the total deductions of an employee. The column net pay total shows the grand total around that will be received by employees. It is called take ***home pay***.

7. **Signature:**

Unless some other document is used; the payroll sheet may be designed to allow a column of a signature of the employees after collection of the net pay.

Major Procedures or Activities Involved in Accounting for Payroll

1. Gathering the necessary data - all the relevant information about every employee should be gathered. This activity requires reviewing various documents and to do so some arithmetic work.
2. Including the names of employees along with the gathered data such as earnings, deductions, and net pays in the appropriate columns of the payroll register.
3. Totaling and proving the payroll register. It must be proved that the grand total earnings equal to the sum of the grand totals of deductions and net pays in the register.
4. The accuracy and authenticity of the information summarized in the payroll should be verified by different person from the one who compiles it.
5. The payroll is approved by the authorized personnel
6. Paying the payroll either in cash or issuing a check for every individual employee for the net amount payable to each employee.
7. Recording the payment of the payroll and recognition of the withholding tax liabilities.
8. Recording the payroll tax expense of the employer
9. Paying and recording withholding and payroll tax liabilities to the concerned authority in our case to the Inland Revenue Authority, on time.

__Illustration__ ***of a Payroll Register***

Addis Garment Factory, a public business organization, pays the salary of its employees according to the Ethiopian calendar month. The forth-coming data related to the month of January, 2016.

S/N	Name of Employee	Basic salary	House Allowance	Hardship allowance	OT hours worked	Duration of work
01	Habitamu Belaye	8,600	400		15	Up to 10:00pm.
02	FasilAbiy	2,500	200	300	12	6 hours up to 10:00pm. 6 hours on public holiday
03	Eden Dawit	1,600	-		6	Weekly Rest days
04	AbdiTekel	500	100		-	-
05	Mohamed Ali	900	100	200	20	15 hours on weekly rest days & 5 hours during public holidays

Additional information

The management of the organization usually expects all workers to work 160 hours in a month and during the month of January,2017all workers have done as expected.

Besides, all workers of the organization are permanent employees except AbdiTekel. Fasil and Habitamu agreed to contribute monthly of Br 300 each for a charity organization (for Hope project).

Instructions: Based on the above information:

1. Prepare a payroll register for the organization for the month of January, 2017.
2. Record the payment of salary as of January 31, 2017using cash.
3. Record the payroll tax expense for the month of January.
4. Record the payment of the claim of the Charitable organization that arose from January, 2017payroll assuming that the payment was made on February 5, 2017.
5. Assuming that the withholding taxes and payroll taxes of the month of January, 2017have been paid on February 6, 2017, record the required journal entry.
6. ***Solution***

1. A payroll is registered in the payroll register. A payroll register is a multi-columnar form used to organize the payroll data of an organization at the end of each pay period. A payroll register would include: Employee number, names of employees, earnings of each employee, deductions, net pay, and signature. Hence, these inputs should be prepared as follows:

a) ***Overtime earning (OT)***

OT = OT hours worked X (ordinary hourly rate X OT rate)

Ordinary hourly rate = basic salary ÷ required monthly working hours

S/N	Name of Employee	Basic Salary	Required Monthly Working Hours	Ordinary Hourly Rate
01	HabitamuBelaye	8,600	160 hours	Br 8,600/160 = Br 53.75
02	FasilAbiy	2,500	160 hours	Br 2,500/160 = Br 15.625
03	Eden Dawit	1,600	160 hours	Br 1,600/160 = Br 10.00
04	AbdiTekel	500	160 hours	Br 500/ 160 = Br 3.125
05	Mohamed Ali	900	160 hours	Br 900/160 = Br 5.625

01. HabitamuBelaye

OT = OT hours worked X (ordinary hourly rate X OT rate)

OT = 15 hrs x (Br 53.75 x 1.25) = **Br 1,007.80**

02.

03. FasilAbiy OT = 6 hrs x (Br 15.625 x 1.25) = **Br 117.19**

+ OT = 6 hrs x (Br 15.625 x 2.5) = **Br 234.38**

Br 351.57

04. Eden Dawit .OT = 6 hrs x (Br 10.00 x 2.0) = **Br 120.00**

05. Mohamed Ali

OT = 15 hrs x (Br 5.625 x 2.0) = **Br 168.75**

+ OT = 5 hrs x (Br 5.625 x 2.5) = **Br 70.31 Br 239.06**

b) Gross Earnings

Gross Earnings: *is total amount of money earned by an employee from various sources. Example includes basic salary, allowance, and overtime.*

Gross earnings = Basic salary + Allowance + OT earnings

S/N	Name of Employee	Basic Salary	House Allowance	Hardship allowance	OT Earnings	Gross Earnings
01	HabitamuBelaye	8,600	400		1,007.80	10,007.8
02	FasilAbiy	2,500	200	300	351.57	3,351.57
03	Eden Dawit	1,600	-		120.00	1,720
04	AbdiTekel	500	100		-	600
05	Mohamed Ali	900	100	200	239.06	1,439.06
Total		**14,100**	**800**	**500**	**1,718.43**	**17,118.43**

c) Deductions and net pay

Gross Taxable Income = Gross Earnings – Non Taxable Allowances

Pension Contribution = 7% x Basic Salary ➔ from employees' basic salary

S/N	Name of Employee	Gross	Non Taxable	Gross

		Earnings	Allowances	Taxable Income
01	HabitamuBelaye	10,007.8	-	10,007.8
02	FasilAbiy	3,351.57	300	3,051.57
03	Eden Dawit	1,720	-	1,720.00
04	AbdiTekel	600	-	600.00
05	Mohamed Ali	1,439.06	200	1,239.06
Total		**17,118.43**	**500**	**16,618.43**

01. HabitamuBelaye: Income tax and pension

			Gross Earnings
Income tax = (gross taxable income x tax rate)-deduction			**10,007.80**
Income tax	= (10,007.8 X 30%) – 955	= Br 2,047.34	
Pension contribution	= 7% x 8,600	= 602.00	
Charity contribution	(other deduction)	= 300.00	
Total Deductions			**2,949.34**
Net Pay			**Br 7,058.46**

02. FasilAbiy

Gross Earning Income			**Br 3,351.57**
Income tax	= (3,051.57X15%) – 142.5	= Br 315.24	
Pension contribution	= 7% x 2,500	= 175.00	
Charity contribution	(other deduction)	= 300.00	
Total Deductions			**790.24**
Net Pay			**Br 2,561.33**

03. Eden Dawit

Gross Earning Income			**Br 1,720.00**
Income tax	= (1,720.00X15%) – 142.5	= Br 115.50	
Pension contribution	= 7% x 1,600	= 112.00	
Total Deductions			**227.50**
Net Pay			**Br 1,492.50**

04. AbdiTekel

Gross Earning Income			**Br 600.00**
Income tax	= (600X 0%)	= 0.00	
Pension contribution	= no pension (b/c not permanent)	= 0.00	
Total Deductions			**0.00**
Net Pay			**Br 600.00**

05. Mohamed Ali

Gross Earning Income			**Br 1,439.06**
Income tax	= (1,239.06X 10%) – 60*	= Br 63.90	
Pension contribution	= 7% x 900	= 63.00	
Total Deductions			**126.90**
Net Pay			**Br 1,312.16**

*hardship allowance of Mohamed birr 200 is not taxable

2. Record the payment of salary as of January 31, 2017 using cash.

Salaries expense……………………… 17,118.43

Income tax payable ……………………2,541.98

Pension contribution payable …………. 952.00

Charity contribution …………………… 600.00

Cash ……………………………………. 13,024.45

3. Record the payroll tax expense for the month of January.

Payroll tax expense = 11% of basic salary of permanent of employees (from employer)

Payroll tax expense = 11% x 13,600=1,496

Payroll tax expense …………………......... 1,496

Pension contribution payable ……………. 1,496

From employees = 7% x 13,600= ***952.00***

*+ From employer = 11% x 13,600 =**1,496.00***

Total pension contribution towards the gov't pension trust fund = 2,448.00

4. *Record the payment of the claim of the Charitable organization that arose from January, 2017 payroll assuming that the payment was made on February 5, 2017.*

Charity contribution ………………… 600.00

Cash ……………………………………... 600.00

5. Assuming that the withholding taxes and payroll taxes of the month of January, 2017 have been paid on February 6, 2017, record the required journal entry.

Income tax payable ……………………… 2,541.98

Pension contribution payable …………… 2,448.00

Cash ………………………………………….4,989.98

Addis Garment Factory

Payroll Sheet

For the month ended January 31, 2017

S/N	Name of Employee	Earnings				Gross Earnings	Deductions			Total Deduction	Net Pay	Signature
		Basic Salary	House Allowance	Hardship allowance	OT Earnings		Employment Income Tax	Pension Contribution	Other Deductions			
01	Habitamu B	8,600	400		1,007.80	10,007.8	2,047.34	602.00	300.00	2,949.34	7,058.46	
02	FasilAbiy	2,500	200	300	351.57	3,351.57	315.24	175.00	300.00	790.24	2,561.33	
03	Eden Dawit	1,600	-		120.00	1,720	115.50	112.00	-	227.50	1,492.50	
04	AbdiTekel	500	100		-	600	0.00	0.00	-	0.00	600.00	
05	Mohamed A	900	100	200	239.06	1,439.06	63.90	63.00	-	126.90	1,312.16	
Total		**14,100**	**800.00**	**500**	**1,718.43**	**17,118.43**	**2,541.98**	**952.00**	**600.00**	**4,093.98**	**13,024.45**	

1.3.4. Internal Controls For Payroll Systems

The cash payment controls, internal control of cash, also apply to payrolls. Some examples of payroll controls include the following:

- ✓ If a check-signing machine is used, blank payroll checks and access to the machine should be restricted to prevent their theft or misuse.
- ✓ The hiring and firing of employees should be properly authorized and approved in writing.
- ✓ All changes in pay rates should be properly authorized and approved in writing.
- ✓ Employees should be observed when arriving for work to verify that employees are "checking in" for work only once and only for themselves. Employees may "checkin" for work by using a time card or by swiping their employee ID card.
- ✓ Payroll checks should be distributed by someone other than employee supervisors.
- ✓ A special payroll bank account should be used.

3.4 Presentation of Liabilities on the Balance Sheet

Conceptually, a company should report its three main balance sheet elements - assets,liabilities, and equity - in homogeneous classes. This disclosure is helpful to users inassessing the nature, amount, timing, and liquidity of its resources and obligations. Acompany can report liabilities and assets as items in its balance sheet in various ways.

Current liabilities are the first category under liabilities on the balance sheet. Each of the principal types of current liabilities is listed separately.

In addition, companies disclose the terms of notes payable and other key information about the individual items in the notes to the financial statements.

Companies seldom list current liabilities in the order of liquidity. The reason is that varying maturity dates may exist for specific obligations such as notes payable.

A more common method of presenting current liabilities is to list them by **order of magnitude**, with the largest ones first.

Items within the current liability section typically may be listed:

(1) in the order of theiraverage length of maturity,

(2) according to amount (largest to smallest), or

(3) in the order of liquidation preference - that is, in the order of their legal claims against assets. A popular way of presenting these items is as follows:

- ® Accounts payable
- ® Notes payable
- ® Accrued liability items
- ® Unearned revenue items
- ® Other current liabilities

Other Current Liabilities may include:

- » Accrued payroll
- » Accrued interest
- » Accrued taxes
- » Miscellaneous, etc.

A company includes any major issue affecting its current liabilities in a note to its financial statements. This presentation is made so that the notes and other supplemental information about current liabilities meet the requirement of ***full disclosure***.

To illustrate, look at balance sheet of ABC Company showing how it reportsits current liabilities

	May 30,2004	May 25, 2003
(millions of dollars)		
Liabilities (in part)		
Current liabilities:		
Accounts payable	$1,145	$1,303
Current portion of long term debt	233	105
Notes payable	583	1,236
Other current liabilities	796	800
Total current liabilities	$2,757	$3,444

Other current liabilities:		
Accrued payroll	$230	$243
Accrued interest	186	178
Accrued taxes	249	129
Miscellaneous	131	250
Total other current liabilities	$796	$ 800